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Supreme Court of the United States

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Petitioners,

v.

CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE; DEBORAH A. MELNYK; JOHN/JANE DOES 1-10; CONSOLIDATED RAIL CORPORATION MATCHED SAVINGS PLAN,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

REPLY BRIEF FOR PETITIONERS

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FURTHER REASONS FOR GRANTING THE WRIT

I.

THE DECISION BELOW MARKS A SIGNIFICANT DEPARTURE FROM THE ESTABLISHED UNDERSTANDING IN OTHER CIRCUITS THAT ERISA GOVERNS CONDUCT RELATING TO IMPLEMENTATION OF A PLAN TERMINATION AND DISTRIBUTION OF PLAN ASSETS.

Respondents' Brief in Opposition serves to further demonstrate the extent to which the Third Circuit established conflicting precedent by holding that no substantive provision of ERISA governs the disposition to participants of surplus assets after the termination of a non-reversionary plan. According to Respondents, ERISA now must be understood to insulate from review all conduct relating to disposition of assets following a plan termination. Respondents argue this despite the fact that the Court has not addressed the fiduciary and other statutory duties that apply under ERISA when a plan is terminated, and even though multiple provisions of ERISA expressly govern this situation and set forth mandatory rules for the allocation of plan assets. In several key aspects, the decision below is contrary to settled precedents in eight other circuits. If left unreviewed, it will spawn a host of new conflicting rulings that nullify the ERISA protections that govern in these circumstances.

Like the court below, Respondents misread and stretch beyond recognition the Court's decisions in *Hughes Aircraft Co. v. Jacobson*, __ U.S. __, 119 S. Ct. 755, 763 (1999), and *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996). Both of these decisions concerned ongoing plans, not terminated plans. Both concerned employers' business decisions about how to

design benefits and thereby use plan assets to fund ongoing benefits. The Court ruled that these are matters of plan design that generally are not constrained by ERISA's strict fiduciary duties. The Court accordingly had no occasion to address the much different circumstances presented in this case — a terminated plan and the proper disposition of its surplus assets in conformity with ERISA's fiduciary duties and plan termination provisions. Despite Respondents' mischaracterization of this case as being similar to *Spink* and *Jacobson*, it clearly does not involve any challenge to use of assets in an ongoing plan, does not implicate any statutory policy allowing employer latitude in its proper sphere of operation, and accordingly does not invoke the principles established in those decisions. The clear conflicts between the decision below and other circuit decisions cannot be explained away or ignored on the basis of *Spink* and *Jacobson*.

Like the court below, Respondents maintain that Petitioners have no "legally cognizable interest" (Opp. Br. at 9) in the surplus assets of their Plan when it terminated and that Respondents had free rein to do whatever they wished, including implementing an invalid, post-termination amendment of the Plan in order to give away massive sums of money to themselves and current employees who had little or no history of participation in the ESOP and Plan.[1] Respondents' argument ignores the plain terms of ERISA that govern plan terminations

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1. Respondents are less than candid when they tell the Court that their asset allocation scheme only distributed the surplus to "Plan participant[s]." (Opp. Br. at 5 n.6; 9-10 n.9). Respondents fail to inform the Court that the same post-termination amendment that adopted the asset allocation scheme also purported to designate as a "Participant" every person who was an employee between January 1, 1996 and the date the plan terminated, irrespective of his or her lack of participant status before the plan terminated. (3d Cir. App. at A 095, 117).

and that Petitioners necessarily can enforce. The argument also conflicts with the multiple circuit precedents, cited in the Petition, which emphasize that ERISA §§ 403(d)(1) and 4044 and the implementing regulations establish a regime that plan administrators must follow when allocating and distributing all of the assets of a plan upon its termination. *See* 29 U.S.C. § 1103(d)(1) ("*Upon termination . . . the assets of the plan shall be allocated* in accordance with the provisions of section 4044"); 29 U.S.C. § 1344(a) ("In the case of the termination of a single-employer plan, the plan administrator *shall allocate the assets of the plan . . . among the participants and beneficiaries of the plan*"); 29 C.F.R. § 4044.3(a) ("Upon the termination of a single-employer plan, the plan administrator *shall allocate the plan assets*"; "Plan assets available to pay for benefits include *all plan assets* . . .").[2]

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2. Despite these provisions governing asset allocations on plan termination, Respondents seek refuge in a *pro forma* IRS determination letter issued in January 1998 in connection with the termination of the Plan. It is not known what issues and facts the IRS considered or what the letter stands for. Courts accordingly give no weight to such determination letters because of their informal, ex parte nature, the limited record on which they are based, and the lack of explanation offered. *See, e.g., Hickey v. Chicago Truck Drivers Union*, 980 F.2d 465, 469 (7th Cir. 1992):

> The letter expressly limited its applicability to the Plan's status under the Internal Revenue Code. Neither letter included any discussion of the reasoning employed by the agency in reaching its conclusions. Given the informal nature of these letters, the express limitations included in the IRS letter, and the absence of any reasoning to explain the basis for the statements, we do not think that any implication in either of these letters that elimination of the COLA was lawful is entitled to deference. *See Shatto v. Evans Products Co.*, 728 F.2d

(Cont'd)

With no support other than the decision below, Respondents argue that ERISA § 4044(a) does not govern disposition of the surplus assets and is "irrelevant." (Opp. Br. at 18). But the statute, through 29 U.S.C. § 1103(d)(1), indisputably mandates use of § 4044 and the implementing PBGC regulations in connection with the termination of the ESOP and allocation of its assets. Both Respondents and the court below agree that § 4044(d) is not applicable to this case. Accordingly, the only other applicable section is § 4044(a), and that provision requires an equitable pro-ration of "the assets of the plan" among all participants. Respondents do not offer any explanation of what they think the statute means when it directs that "the plan administrator *shall allocate* the assets of the plan" in accordance with section 4044. Although Respondents and the decision below

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1224, 1228 n.2 (9th Cir. 1984) (IRS determination entitled to no deference because based on limited evidence).

The Third Circuit apparently was persuaded by these authorities and it made no reference to the determination letter.

Respondents also suggest that their conduct was justified by supposed tax considerations and that an equitable allocation of assets would have resulted in a tax disqualification. (Opp. Br. at 4). But this is contrary to the IRS Tax Advice Memorandum that Respondents themselves presented, 3d Cir. Appendix at A 315-18. It also is contrary to established precedents such as *Rinard v. Eastern Co.*, 978 F.2d 265, 269 (6th Cir. 1992), *cert. denied*, 507 U.S. 1029 (1993), where all plan surplus was allocated to former employees and their surviving spouses. In this case, neither the district court nor the court of appeals determined that tax considerations would justify the allocation scheme. Respondents also argue that plaintiffs' allegations support the tax law argument. This likewise has no basis. Although the complaints recited that respondents were purporting to allocate the maximum allowable amounts to the favored employees, that clearly did not signal any agreement with the challenged scheme.

ignore the words of the statute, the conflicting circuit decisions do not.

As held in the conflicting circuit decisions noted in the Petition, the allocation of the surplus ESOP assets upon its termination is an activity that also is governed by ERISA's strict fiduciary duties, enumerated at 29 U.S.C. § 1104(a). When a plan administrator allocates or distributes plan assets, that clearly is conduct "exercis[ing] any authority or control respecting management or disposition of [plan] assets" and the conduct therefore falls within ERISA's definition of fiduciary activity. 29 U.S.C. § 1002(21)(A)(i). In the face of the contrary circuit decisions and the statutory definition itself, Respondents try to obscure the conflict and defend the decision below by arguing that their conduct in distributing the assets was not "discretionary." (Opp. Br. at 15-16). But Respondents studiously avoid a faithful quotation of the pertinent portion of the statutory definition of fiduciary status. The definition requires "discretionary" authority or control only with respect to matters that do *not* relate to plan assets. *Id.* Where plan assets are concerned, "*any* authority or control" is sufficient to create fiduciary status and invoke ERISA's strict duties.

Respondents' argument that fiduciary duties do not apply also assumes that they had no choice as fiduciaries but to implement the distribution scheme that was inserted by the invalid post-termination amendment of the Plan (Opp. Br. at 15), and that it was of no consequence that the scheme violated the mandatory termination provisions of the statute and strict fiduciary duties. But ERISA directs otherwise. A fiduciary is permitted to follow plan terms only "insofar as [they] are consistent with [ERISA §§ 1-733 and 4001-4402, 29 U.S.C. §§ 1001-1191c and 1301-1461, *i.e.* subchapters I and III as codified]." 29 U.S.C. § 1104(a)(1)(D) (A. 73a). Fiduciaries most certainly *do* have "discretion" to refuse to

follow plan terms that violate ERISA. ERISA prohibits the evasion of statutory protections through the strategem of amending the plan to insert contrary language. Statutory rights also cannot be extinguished by failing to include conforming terms in the plan, and it is of no significance that the ESOP did not expressly provide for the required allocation. Put simply, fiduciaries must follow the law, and it is no defense that "I was only following the Plan."

Save for their legally groundless distinction between supposedly discretionary and non-discretionary acts, Respondents offer no other argument to overcome the conflicting precedents from three other circuits holding that the disposition of plan assets on plan termination is governed by ERISA's strict fiduciary duties.

Respondents also fail in their effort to obscure the conflict between the decision below and other precedents with respect to the claim that a partial termination occurred in the ESOP as a result of separations of participants in the years preceding its final termination. While it is true that the governing provision of the Internal Revenue Code, 26 U.S.C. § 411(d)(3), does not itself refer to allocations of plan assets upon a partial termination, the longstanding Treasury Regulation promulgated in 1977 certainly does. This controlling regulation expressly states that a plan (including the Conrail ESOP) must "provide[ ] for the allocation of any previously unallocated funds to the employees [i.e. participants] covered by the plan upon the termination *or partial termination* of the plan." Treas. Reg. § 1.411(d)-2(a)(2)(i) ("Required allocation") (emphasis added) (A. 84a-85a).[3]

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3. Respondents (Opp. Br. at 25 n.26) are forced to misquote and mischaracterize the regulation. If Respondents had quoted the complete sentence of the regulation, their quotation would have made

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The applicability of this asset allocation provision to partial terminations in non-reversionary plans was made clear in *Borst v. Chevron Corp.*, 36 F.3d 1308 (5th Cir. 1994), *cert. denied*, 514 U.S. 1066 (1995). Where a plan "preclude[s] amendment providing for reversion of surplus to the employer on complete termination", then employees are entitled to receive an allocation of assets upon the partial termination, just as the district court had ordered in that case with respect to the "CRP" plan. *Id.* at 1312-13 & n.6; 1317; 1318 n.17, *citing In Re Gulf Pension Litigation*, 764 F. Supp. 1149, 1192 (S.D. Tex. 1991). Respondents instead cite inapposite decisions, *e.g.*, *Ashenbaugh v. Crucible, Inc. 1975 Salaried Retirement Plan*, 854 F.2d 1516, 1520, 1525 (3d Cir. 1988), which relate to plans that either had no surplus or allowed reversion to the employer. In those circumstances, the partial termination rule will not present any issue of funding unfunded benefits or allocating surplus assets. The decision of the Third Circuit conflicts with the Fifth Circuit's decision in *Borst* and the Treasury Regulation with respect to the partial termination claim.

In summary, the conflicts between the decision below and the other circuit precedents cited in the Petition are real and significant. Until the decision in this case, employers, fiduciaries, participants and government regulators properly understood that ERISA safeguards applied to the actions of

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clear that the language on which they rely relates to *forfeitures of account balances that are transferred to a suspense account*, a circumstance that does not apply here: "In the case of a defined contribution plan under which unallocated forfeitures are held in a suspense account, ..." § 1.411(d)-2(a)(2)(i) (A. 85a). Similarly unavailing is Respondents' statement that they do not understand that the regulation's reference at § 1.411(d)-2(a)(2)(iii) (A. 86a-87a) to the antiinurement provision, IRC § 401(a)(2), explains only that the required allocation does not extend to assets that may revert to the employer — another circumstance not pertinent to this case.

plan administrators and other fiduciaries in allocating assets upon a plan termination and that plan terms were ineffective to oust these statutory provisions. The Third Circuit's contrary ruling now creates fundamental uncertainty about the principles to be followed when a plan terminates and its assets are distributed. The decisional conflict and the need for certainty in this important area fully warrant intervention by the Court.

CONCLUSION

For the reasons stated here and in their petition, Petitioners respectfully pray that the petition be granted and that a writ of certiorari issue to the Court of Appeals for the Third Circuit.

Respectfully submitted,

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